

OFTA's bid for auctions

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After the UK auctions for third generation (3G) mobile licences raised US\$34 billion and the German auctions raised a further US\$46 billion the call went up 'here too'. Then came OFTA's second consultation paper on the subject, and the cry went up 'U-turn'. After favouring a beauty contest, was OFTA not now admitting that an auction was the better way?

Well, yes and no; yes OFTA now admits that some form of auction is appropriate, but no, not the kind that raised so much money in Europe. OFTA is correct in this view, but does not go far enough. Why is this important and what should OFTA do?

Let me make what sounds like a technical point first.

A policy decision should first and foremost be based upon clearly stated and thought-through policy objectives. Furthermore, as an economist, I was taught a theorem which said that for each policy objective you need a policy instrument, one instrument cannot efficiently serve two objectives. In other words, aiming to kill two birds with one stone is not a basis for good policy making. You need an extra stone.

My first criticism of the second consultation paper is that it does not state the policy objective nearly clearly or loudly enough. It still leaves room for doubt, and for those who are looking for a free lunch. Let me make myself plain.

A number of policy objectives are possible, but two in particular have gained some support. In my view one of them is correct and the other is just plain wrong.

The first aim is to develop a highly competitive and vigorous market structure for the development of the 3G business, so competitive in fact that the value any bidder places on a licence in an auction will be low. The second aim is to raise lots of money for the government.

These policy objectives are contradictory, and if policy targets both of them it falls between two stools. In economist's jargon, policy is 'under-determined'. I have no problem in principle with a government saying, well we have thought it through, we know we are a poor country, we need to prioritize hospitals and schools over broadband mobile Internet access, so 3G will be treated as a luxury for the few and it will be heavily taxed. Even if this is shortsighted thinking, at least it is thinking.

But it is not Hong Kong's situation. On the contrary, Hong Kong's economy looks increasingly towards tradeable services, and the e-commerce and content and applications that will be stimulated by a vigorously competitive 3G industry will make an important contribution to future employment and public prosperity.

The key issue therefore is, how to ensure that 3G service access is treated from the outset as a cheap mass commodity, and not as a premium priced luxury good? There is a crucial difference in this respect between 2G and 3G.

Before 1996 when the six new PCN mobile phone networks started services there was little price competition between the four cellphone operators. This was good for returns on investment, and since everyone had access to a fixed wireline telephone and a mobile pager arguably it did not matter that 2G started life as a luxury product.

But 3G is different because its success depends upon a robust development of content and applications services, and they in turn depend upon a mass demand for access to these services. We don't restrict the

number of Internet service providers for people who want to surf the Web or send emails, and anyone can have a PNETS licence to operate Internet access for just HK\$750. This encourages mass take-up, and we need to do this for 3G. Ideally we need licences that fetch HK\$750 in an auction!

Of course, spectrum is a scarce resource which limits the number of licences and therefore raises their market value. OFTA quite rightly proposes to open the access service market by requiring wholesaling of spectrum by licence holders, and by permitting 2G operators to offer 3G-type services as and when their technology permits.

My second concern about the consultation paper is that OFTA should also make it much clearer that when additional spectrum becomes available as many additional licences will be issued as there is a demand for them by would-be service providers. This again will deflate the value of the licences. And to emphasize the point, OFTA should issue six licences now rather than four. Keeping them down to four sends the wrong policy signal.

Finally, on the auction proposal itself. The consultation paper rejects both the high-priced money-up-front UK type auction and the lowest wholesale price 'reverse' auction in favour of a 'hybrid' which, after a pre-qualification process, involves a minimum royalty payment plus an auction on a sliding scale royalty payment as and when 3G operating revenues rise above the minimum.

May I (modestly, of course) point out that this is a variant of my own proposal in response to the first consultation paper, although I prefer a profits rather than a revenue base. It seems OFTA thinks there are too many clever tax accountants around to make that one fly. The hybrid has the advantage of spreading the payments and taxing only the super-profits if and when they arise. Hopefully they won't arise, because the price of access will remain too low, but only if there is abundant competition. In my view that would kill off once and for all the idea that the policy objective is to raise money for the treasury rather than develop a high competitive industrial structure.